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July 11, 1996

William F. Caton
Secretary
Federal Communications Commission
1919 M Street, NW
Room 222
Washington, D.C. 20554

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Dear Mr. Caton:

RE: Ex Parte Notice, CC Docket No. 96-98

On July 9, 1996, USTA representatives met with Jim Lande and Doron Fertig regarding the FCC's IDSS Model. USTA representatives included the undersigned, Rosemary Spell (Bell Atlantic), Whit Jordan (BellSouth) and Howard Ware, Chris Cichoski, and Chienyo Fung of NERA. At this meeting, the discussion centered around the points contained in the attachments. These points were made in USTA's comments filed in the proceeding.

An original and one copy are being filed. Please include a copy of this filing in the record of this proceeding.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Keith Townsend".

Keith Townsend
Director
Regulatory Affairs & Counsel

cc Jim Lande (Industry Analysis Division)
Doron Fertig (Office of the General Counsel)

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The IDSS Model - A Critical Evaluation

National Economic Research Associates

July 8, 1996

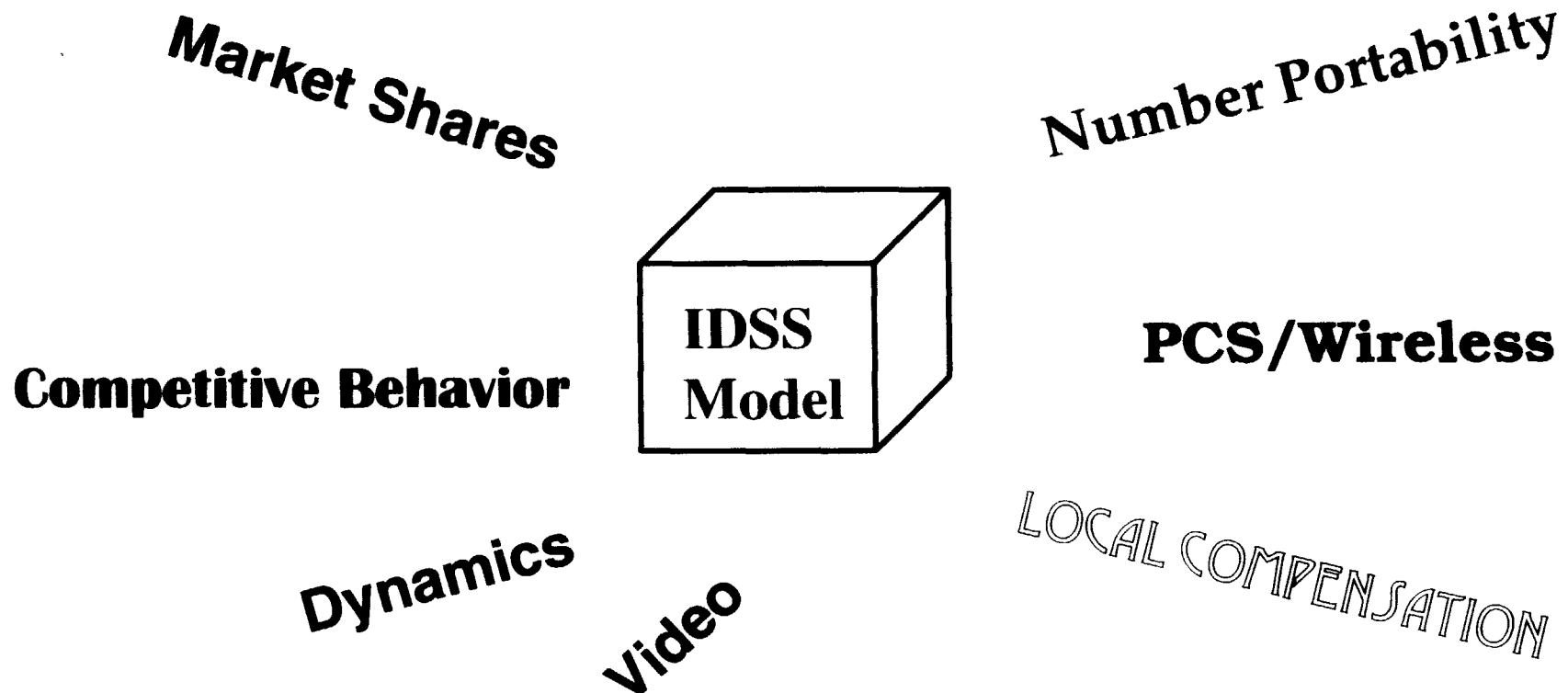
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Scope of the IDSS Model

Determinants of LEC Revenue by Category

End Users	CLEC	IXC
<ul style="list-style-type: none">• Total Bill - Residual• Business - Residence• Special Access	<ul style="list-style-type: none">• Facilities Based - Unbundled• Traditional - CIC Access Rates	<ul style="list-style-type: none">• Bypass

The Big Picture of the IDSS Model: Many Important Factors are Outside the Model



The Model Oversimplifies the Telecommunications Industry

- A single aggregate LEC masks different effects on real-world LECs and produces a biased prediction of the total industry effect.
- Does not explicitly model local interconnection or resale of LEC retail services.
- Prices and market shares are not linked.

Model Contains Numerous Arithmetic and Coding Errors

A

Panic Expense Reduction part I					0.0000
Panic Expense Reduction					0.0%
Base Line Depreciation	0.08634	0.086318	0.086531	0.070871	0.07%
Actual Depreciation Rate	0.08654	0.086318	0.086531	0.070871	0.07%
Increase in Depreciator	0.278808	0.308289	0.454561	0.448808	0.55%
Growth Rate in Other Taxes		1.9%	1.5%	0.4%	1.0%
Interest Expense as per	3.0%	2.7%	2.6%	2.4%	2.0%
Effective FIF rate	31.0%	32.4%	31.8%	33.1%	33.3%
Shareholders equity as :	49.8%	49.3%	48.6%	45.7%	48.0%
Operating Expense	\$67.0	\$68.0	\$71.2	\$71.7	\$74.0
Annual Depreciation	\$18.1	\$18.6	\$19.3	\$17.2	\$17.4
Operating Profit	\$23.6	\$25.1	\$25.4	\$24.5	\$27.4
year over year changes		5%	1%		11%
Margin on total bill: Toll revenue					\$0.0
Gross Profit worksheet					
Replacement Investment (and special access		\$12.6	\$13.4	\$12.0	
Rebates/offset by net added business lines		\$10.5	\$11.2	\$8.0	
Net Replacement Investment		\$2.1	\$2.2	\$4.0	
Prior year gross profit		\$27.21	\$28.20	\$29.15	
Investment for net added business lines		\$1.5	\$5.3	\$7.6	
Investment for net added households with serv		\$8.0	\$8.0	\$8.0	
Investment for net added additional residential		\$0.2	\$0.2	\$1.0	
Investment for added minutes (Hing LEC switch		\$0.7	\$0.7	\$0.7	
Investment for vertical services		\$2.2	\$2.2	\$0.5	
Investment for Special Access		\$0.0	\$0.1	\$0.0	
Investment for Private Line services		\$0.1	\$0.1	\$0.0	
Investment for other and Misc. services		\$0.1	\$0.0	\$0.1	
Investment for added toll minutes		\$0.0	\$0.0	\$0.0	
Investment in shadow or stranded loops (to olt		\$0.0	\$0.0	\$0.0	

[illegible]

Net Cost Assumptions					
Additional LEC marketing Expense when it bundled loops > 10%					\$0.00
Residential					\$0.00
Business					\$0.00
Additional LEC marketing expense when they go into DCL markets					\$0.00
Residential					\$0.00
Business					\$0.00
Inflation in the whole country	0.03%	0.03%	2.0%	2.0%	2.0%
Special LEC productivity adjustment					2.0%
DOCA annual productivity reduction in states					3.0%
Case Study: Plant and Income Data (Billions)					
Annual Depreciation	\$18.1	\$18.6	\$19.3	\$20.1	\$21.7
Other LEC Operating Exp.	\$48.8	\$49.5	\$51.9	\$54.4	\$58.2
Total LEC Operating Exp.	\$67.9	\$68.0	\$71.2	\$74.4	\$80.4
Earnings Before Interest	\$216	\$25.1	\$25.4	\$27.4	\$31.4
Interest and related item	\$4.8	\$4.5	\$4.3	\$4.1	\$4.9
Other Taxes (before other)	\$4.7	\$4.8	\$4.8	\$4.6	\$4.9
Incomes & Related Taxes	\$4.4	\$5.1	\$5.1	\$5.3	\$5.1
After Tax Profit	\$9.7	\$10.7	\$11.1	\$12.6	\$12.3
LEC Gross Profit (Acct)	\$33.7	\$27.2	\$38.0	\$39.5	\$33.4
Accumulated Depreciation	\$10.2	\$10.9	\$11.4	\$12.6	\$13.7
LEC Net Profit (Acct 35)	\$16.5	\$16.2	\$16.7	\$16.7	\$16.7
Total other liabilities etc.	\$38.2	\$40.9	\$46.3	\$51.9	\$50.8
Rate Base	\$125.3	\$125.2	\$121.0	\$115.6	\$116.8
EBIT DA (Earnings before interest, taxes, depreciation & amortization)	\$41.70	\$43.67	\$44.63	\$48.01	\$48.03
LEC Shareholder Equity	\$91.50	\$91.89	\$77.99	\$75.89	\$77.13
Return					
Rate of return on Model Rate B	12.1%	12.5%	12.5%	14.0%	14.1%
Return on Equity	11.9%	13.1%	13.8%	16.3%	15.9%

Model is Sensitive to Assumptions with a High Level of Uncertainty

Unknowable Fact	Change in Assumption and Resulting Effect on EBITDA
Spec 26 -- Business Local Rates First Year of CLEC Competition	A decrease of 10% from -2.6% results in a loss of \$1.5 billion for the LEC
Spec 73 -- % CLEC Loops Provided With CLEC's Own Facilities	An increase of 20% results in a decrease in LEC earnings of \$5.6 billion .
Specs 79 and 80 -- Percent of LEC "Total Bill" Customers	An increase of 10% starting in 1997 increases LEC earnings by \$6 billion
Specs 117 and 118 -- Total added LEC marketing expense when unbundled loops exceeds threshold: Residence and Business	An increase of \$5 billion results in a \$10.6 billion decrease in LEC earnings.
Specs 119 and 120 -- Total added LEC marketing expense if LEC share of "total bill" customer loops exceeds threshold: Residence and Business	An increase to \$5 billion from \$0 results in a \$10.8 billion decrease in LEC earnings.
Base Case is the n/e/r/a base case. All changes in earnings are based on EBITDA for the year 2006.	

...but the Model Shows Substantial Impact of Potential Policy Decisions

- **Base Case:** Local and interstate toll competition in 1997 with reasonable interconnection policies.
 - **Scenario 1:** Cheap interconnection, resale and unbundled loops.
 - **Scenario 2:** Same as Scenario 1 with bypass of terminating access.
 - **Scenario 3:** CLEC purchases all network elements at low TSLRIC.
 - **Scenario 4:** Same as Scenario 3 with bypass of terminating access.
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Figure 1: Predicted Loss in LEC Lines from the Base Case



Figure 2: IDSS Forecast Changes in LEC Local Revenues from Base Case

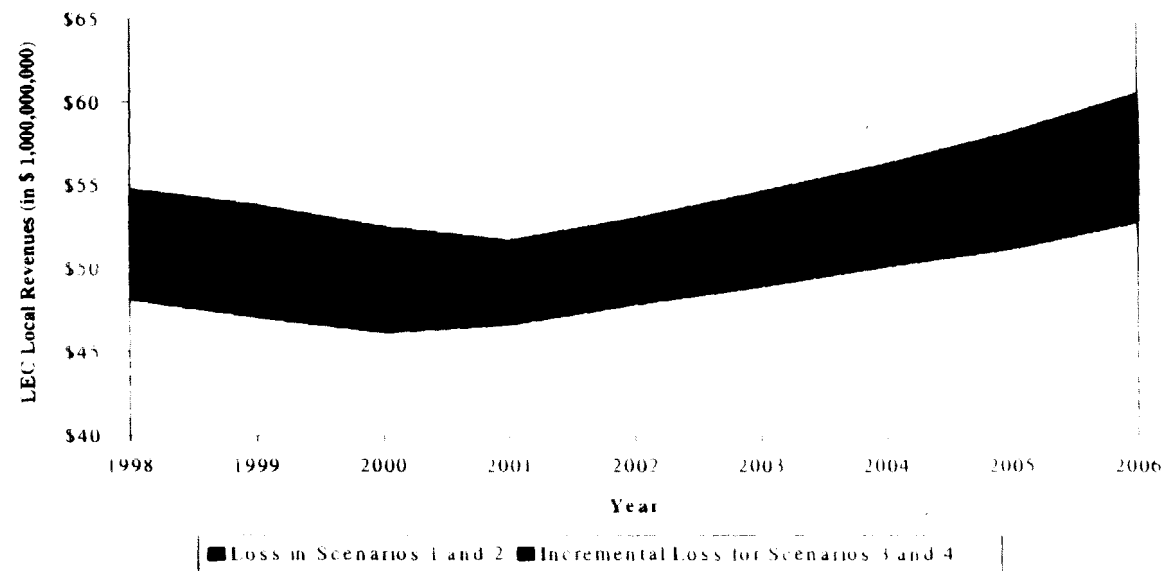


Figure 3: IDSS Predicted LEC Toll Revenue Losses from Base Case



Figure 4: IDSS Predicted LEC Total Revenue Losses from the Base Case

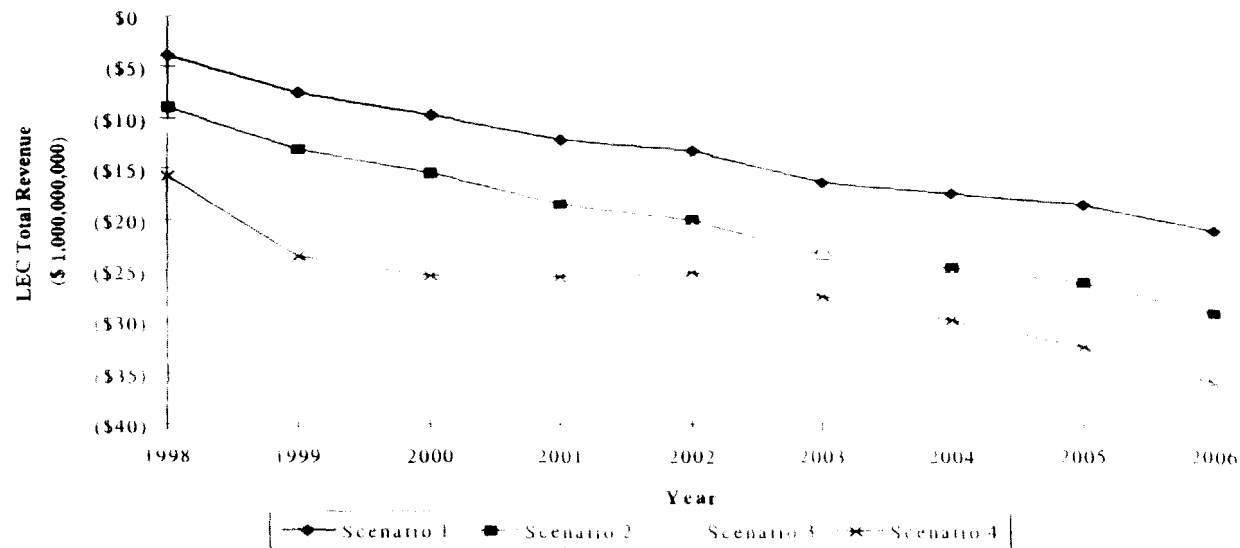


Figure 5: IDSS Predicted Difference in LEC Operating Expense from Base Case

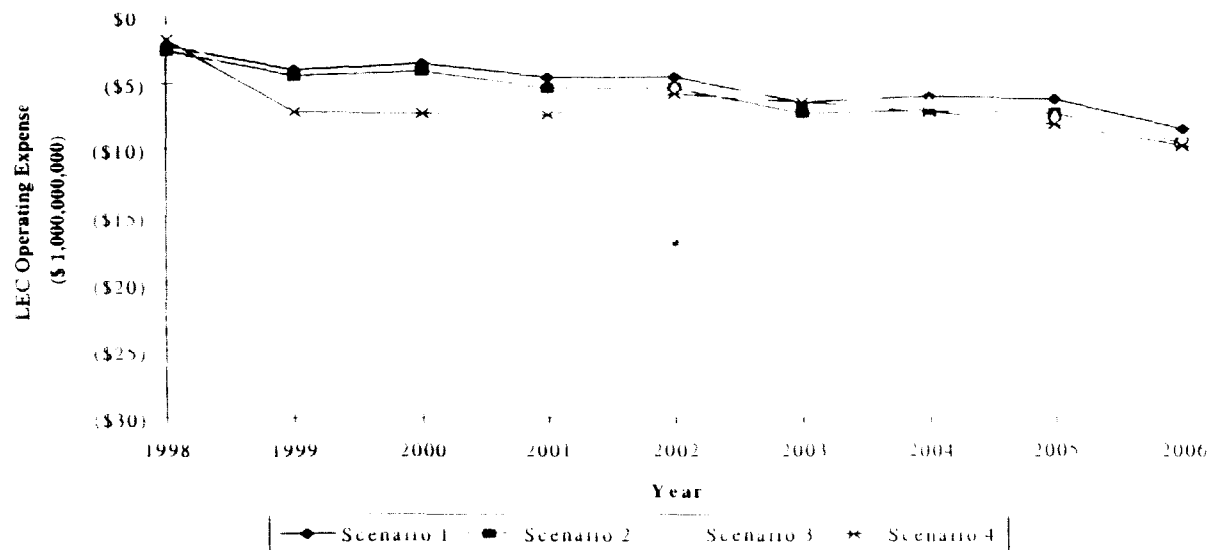


Figure 6: IDSS Predicted Difference in LEC Operating Profits from the Base Scenario

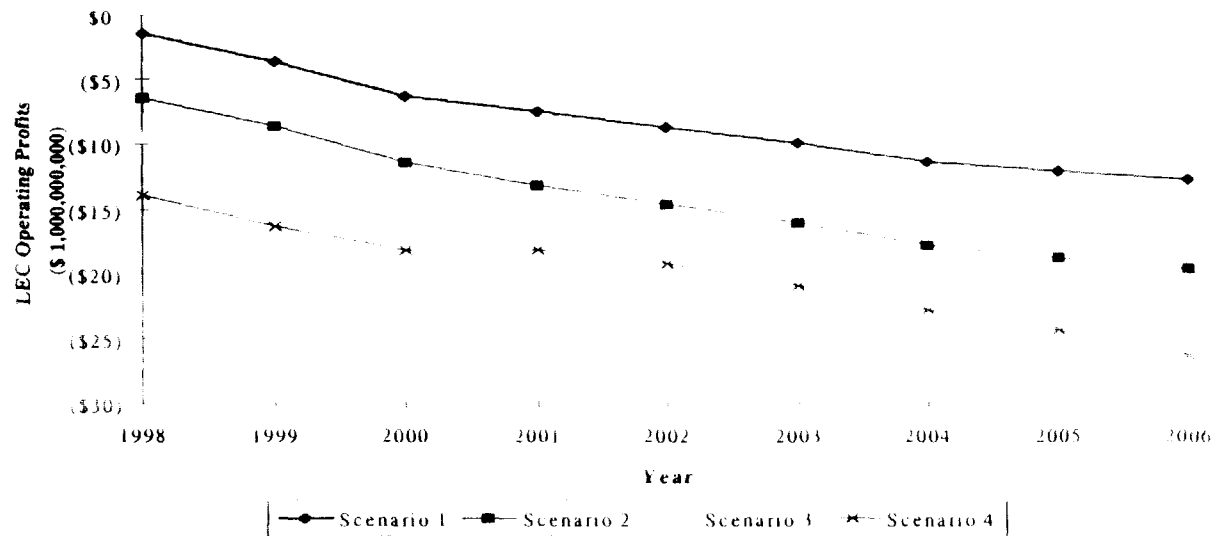


Figure 7: IDSS Predicted Losses in LEC EBITDA from the base case

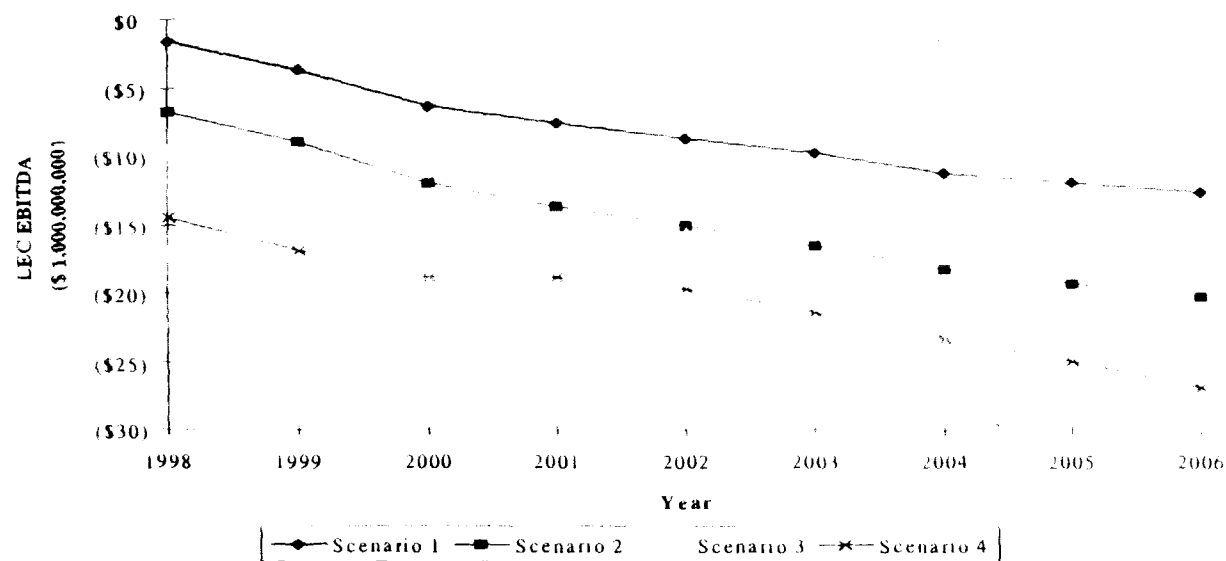


Figure 8: Potential Decline in LEC Equity Value from Base Case

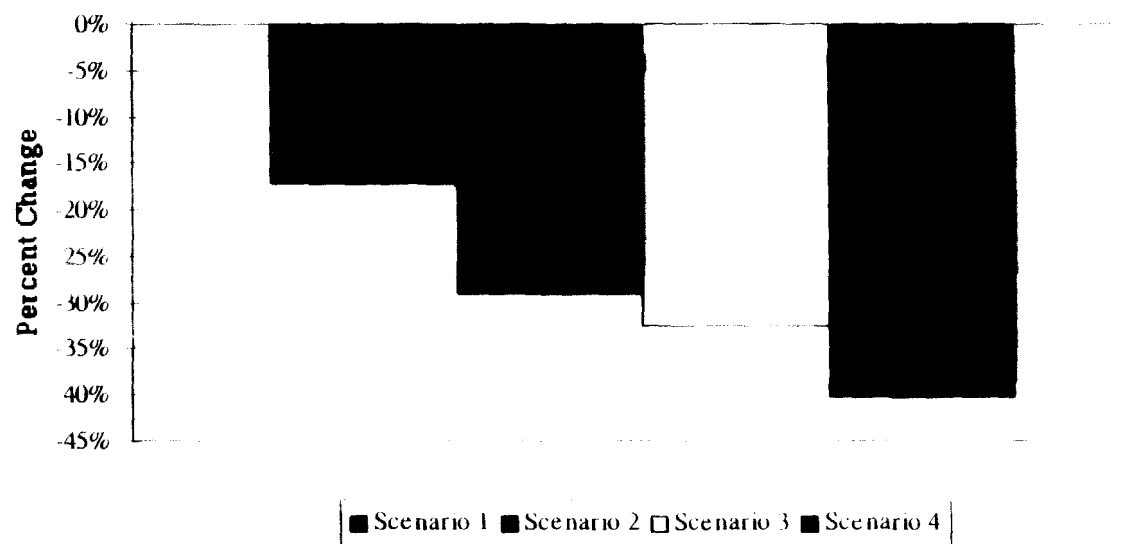
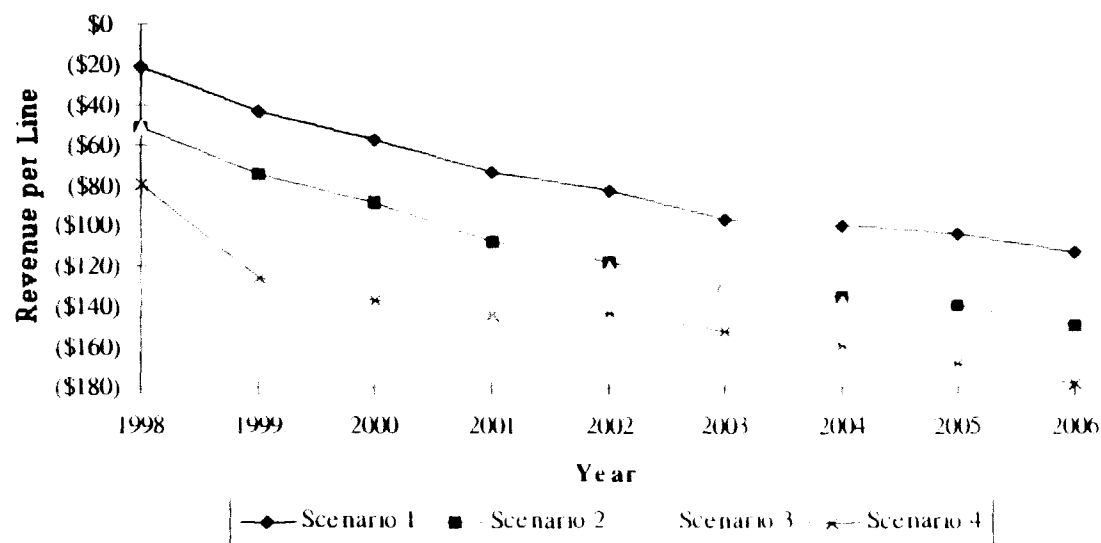


Figure 9: IDSS Predicted Loss in Revenue per Line from the Base Case



Summary of Specifications to Change for Scenarios 1 to 4
(Changes to USTA's Base Case Assumptions Regarding the FCC's IDSS Model)

Scenario 1

Summary of FCC Specifications	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
SPEC 0: Proportion of Terminating Access Diverted	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
SPEC 10 Markup on Unbundled Residential Loop	-39.52%	-40.39%	-41.28%	-41.54%	-41.26%	-42.21%	-43.17%	-44.16%	-44.53%	-44.38%
SPEC 11 Markup on Unbundled Business Loops	8.30%	-7.39%	-21.94%	-30.92%	-34.65%	-35.78%	-36.88%	-37.95%	-39.00%	-40.01%
SPEC 12 Markup on Vertical Services	95.00%	95.00%	95.00%	95.00%	95.00%	95.00%	95.00%	95.00%	95.00%	95.00%
SPEC 67 % of CLEC traffic at alternative rates	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
SPEC 68 Res CLEC Market Share	1.21%	4.78%	10.96%	16.02%	24.79%	27.32%	28.97%	30.18%	31.38%	31.38%
SPEC 69 Bus CLEC Market Share	4.99%	16.77%	24.24%	34.27%	37.47%	38.71%	39.95%	41.19%	42.42%	43.04%
SPEC 72 % of CLEC loops served by CLEC switches	24.25%	33.95%	41.49%	47.65%	49.22%	50.84%	52.69%	54.61%	55.37%	55.55%
SPEC 73 % of CLEC loops that are facilities based	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%
SPEC 79 % of all loops that are LEC total Bill Res	2.71%	9.84%	14.42%	15.65%	16.05%	16.68%	17.35%	18.02%	18.69%	19.06%
SPEC 80 % of all loops that are LEC total Bill Bus	2.69%	9.54%	13.84%	14.65%	15.16%	15.79%	16.40%	17.00%	17.59%	17.88%

Scenario 2

Summary of FCC Specifications	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
SPEC 0: Proportion of Terminating Access Diverted	80.00%	80.00%	80.00%	80.00%	80.00%	80.00%	80.00%	80.00%	80.00%	80.00%
SPEC 10 Markup on Unbundled Residential Loop	-39.52%	-40.39%	-41.28%	-41.54%	-41.26%	-42.21%	-43.17%	-44.16%	-44.53%	-44.38%
SPEC 11 Markup on Unbundled Business Loops	8.30%	-7.39%	-21.94%	-30.92%	-34.65%	-35.78%	-36.88%	-37.95%	-39.00%	-40.01%
SPEC 12 Markup on Vertical Services	95.00%	95.00%	95.00%	95.00%	95.00%	95.00%	95.00%	95.00%	95.00%	95.00%
SPEC 67 % of CLEC traffic at alternative rates	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
SPEC 68 Res CLEC Market Share	1.21%	4.78%	10.96%	16.02%	24.79%	27.32%	28.97%	30.18%	31.38%	31.38%
SPEC 69 Bus CLEC Market Share	4.99%	16.77%	24.24%	34.27%	37.47%	38.71%	39.95%	41.19%	42.42%	43.04%
SPEC 72 % of CLEC loops served by CLEC switches	24.25%	33.95%	41.49%	47.65%	49.22%	50.84%	52.69%	54.61%	55.37%	55.55%
SPEC 73 % of CLEC loops that are facilities based	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%
SPEC 79 % of all loops that are LEC total Bill Res	2.71%	9.84%	14.42%	15.65%	16.05%	16.68%	17.35%	18.02%	18.69%	19.06%
SPEC 80 % of all loops that are LEC total Bill Bus	2.69%	9.54%	13.84%	14.65%	15.16%	15.79%	16.40%	17.00%	17.59%	17.88%

Summary of Specifications to Change for Scenarios 1 to 4
(Changes to USTA's Base Case Assumptions Regarding the FCC's IDSS Model)

Scenario 3

Summary of FCC Specifications	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
SPEC 0.1 Proportion of Terminating Access Diverted	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
SPEC 10 Markup on Unbundled Residential Loop	-19.95%	-20.91%	-21.87%	-22.83%	-23.79%	-24.56%	-25.34%	-26.11%	-26.43%	-26.46%
SPEC 11 Markup on Unbundled Business Loops	-27.54%	-32.09%	-37.53%	-40.75%	-41.76%	-41.44%	-41.11%	-40.78%	-40.44%	-40.09%
SPEC 12 Markup on Vertical Services	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
SPEC 67 % of CLEC traffic at alternative rates	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
SPEC 68 Res CLEC Market Share	6.00%	15.00%	19.20%	22.80%	24.60%	25.80%	27.00%	28.20%	29.40%	30.00%
SPEC 69 Bus CLEC Market Share	10.00%	25.00%	32.00%	38.00%	41.00%	43.00%	45.00%	47.00%	49.00%	50.00%
SPEC 72 % of CLEC loops served by CLEC switches	20.11%	27.78%	36.42%	42.63%	46.39%	48.21%	49.97%	51.68%	52.32%	52.31%
SPEC 73 % of CLEC loops that are facilities based	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%
SPEC 79 % of all loops that are LEC total Bill Res	2.58%	8.78%	13.08%	14.38%	16.09%	17.03%	17.83%	18.53%	19.23%	19.45%
SPEC 80 % of all loops that are LEC total Bill Bus	2.55%	8.60%	12.43%	13.82%	14.31%	14.68%	15.02%	15.32%	15.58%	15.70%

Scenario 4

Summary of FCC Specifications	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
SPEC 0.1 Proportion of Terminating Access Diverted	80.00%	80.00%	80.00%	80.00%	80.00%	80.00%	80.00%	80.00%	80.00%	80.00%
SPEC 10 Markup on Unbundled Residential Loop	-19.95%	-20.91%	-21.87%	-22.83%	-23.79%	-24.56%	-25.34%	-26.11%	-26.43%	-26.46%
SPEC 11 Markup on Unbundled Business Loops	-27.54%	-32.09%	-37.53%	-40.75%	-41.76%	-41.44%	-41.11%	-40.78%	-40.44%	-40.09%
SPEC 12 Markup on Vertical Services	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
SPEC 67 % of CLEC traffic at alternative rates	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
SPEC 68 Res CLEC Market Share	6.00%	15.00%	19.20%	22.80%	24.60%	25.80%	27.00%	28.20%	29.40%	30.00%
SPEC 69 Bus CLEC Market Share	10.00%	25.00%	32.00%	38.00%	41.00%	43.00%	45.00%	47.00%	49.00%	50.00%
SPEC 72 % of CLEC loops served by CLEC switches	20.11%	27.78%	36.42%	42.63%	46.39%	48.21%	49.97%	51.68%	52.32%	52.31%
SPEC 73 % of CLEC loops that are facilities based	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%
SPEC 79 % of all loops that are LEC total Bill Res	2.58%	8.78%	13.08%	14.38%	16.09%	17.03%	17.83%	18.53%	19.23%	19.45%
SPEC 80 % of all loops that are LEC total Bill Bus	2.55%	8.60%	12.43%	13.82%	14.31%	14.68%	15.02%	15.32%	15.58%	15.70%

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